

STATE ECONOMIC REVENUES SHOW SLIGHT IMPROVEMENT

Some national economic indicators appear to be improving and state revenues driven by the economy are beginning to respond, as in the past month income and sales taxes all showed some growth. While this movement is encouraging, a sustained growth is the key to the state's overall fiscal health.

Base revenues (excluding borrowing) increased \$3.335 billion or 20.3% thus far in fiscal year 2004 compared to the same period in fiscal year 2003 and can be primarily attributed to three one time factors, which are unlikely to occur in future years. First, the state issued \$10 billion in Pension Obligation Bonds last year with \$1.860 billion in proceeds allocated to the General Funds in fiscal years 2004 and 2005. Recent legislation has essentially capped the transfers at \$1.395 billion. The remaining \$465 million was transferred directly to the pension systems and payments to the systems for the remainder of the fiscal year were suspended.

Second, the federal Jobs and Growth Tax Relief Reconciliation Act of 2003 allocated a grant of \$422 million to the state and temporarily increased Medicaid reimbursement rates from 50% to 53%. These two factors, in conjunction with over \$650 million more in federally reimbursable spending, have increased federal revenues \$1.222 billion or 43.9%.

Third, the state implemented a tax amnesty program. Through nine months of fiscal year 2004, this program has deposited \$513 million from various sources with \$290 million going to the General Funds. The amnesty program will have an impact on anticipated receipts in fiscal year 2005 and perhaps beyond, particularly in regard to corporate income.

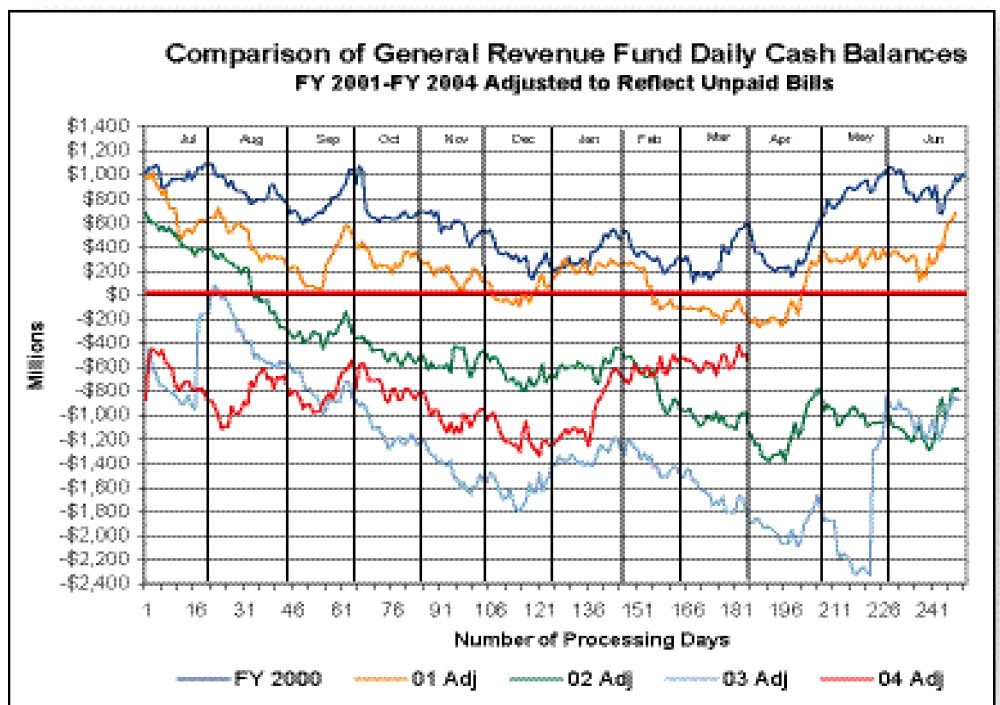
Even with this increased revenue activity, the state still maintains a backlog of unpaid bills. As of March 31, 2004, the existing backlog in the General Revenue Fund totaled \$693 million compared to \$1.913 billion last year. This is reflected in the improvement in the cash balance adjusted to reflect unpaid bills (graph). While short-term borrowing last year reduced the backlog, the repayment of borrowing will in all likelihood increase the backlog over the next three months.

Base Revenues

Total base revenues in the General Funds (excluding short-term borrowing and the transfer from the Budget Stabilization Fund) totaled \$19.726 billion through nine months of fiscal year 2004, an increase of \$3.335 billion or 20.3%. State sources increased \$2.113 billion (15.5%) while federal sources were up \$1.222 billion (43.9%).

Federal sources are up through the third quarter due to the surge of Medicaid payments following \$422 million in federal grants, increased Medicaid reimbursement rates, and increased appropriations.

The increase in state sources is the result of a \$1.636 billion increase in transfers in and a \$477 million increase in cash receipts. The growth in transfers in stems from the transfer of \$1.395 billion from the Pension Contribution Fund. Lottery Fund transfers were up \$38 million while riverboat gambling transfers declined by \$23 million. Riverboat gambling transfers were offset by the increase in taxes which are deposited into the Common School Fund (\$89 million). All other transfers are up \$226 million due to \$185 million in administrative chargeback transfers, \$18 million in fee increase transfers and \$5 million from Executive Order #10 consolidating agency functions.



Sales tax cash receipts increased \$222 million through three quarters of fiscal year 2004 followed by corporate income taxes (up \$173 million), riverboat taxes (\$89 million), public utility taxes (up \$57 million), Cook County IGT (up \$37 million), and insurance taxes (up \$35 million). These increases were partially offset by declines of \$82 million in individual income taxes, \$37 million in inheritance taxes and \$22 million in other sources. Other sources are down due to an \$88 million deposit from tobacco settlement escrow monies last year. Excluding this factor, other sources would have increased \$66 million with most of this growth due to increased fees.

Cash receipts increased in part because \$290 million from the tax amnesty program was deposited into the General Funds. While there was amnesty revenue from various sources, the primary components were \$152 million in corporate income taxes, \$94 million in sales taxes, \$35 million in individual income taxes, and \$10 million in public utility taxes. If amnesty tax sources were excluded, the \$477 million increase in state cash receipts would be \$187 million. Individual income taxes would have fallen by \$117 million; corporate income taxes would have increased by only \$21 million. Sales taxes which increased by 4.9% would have grown \$128 million or 2.8%. It should be noted, however, that changes in the tax refund formula have diverted additional growth in income tax revenues to allow for timelier processing of tax refunds.

Expenditures

Through March, General Funds expenditures totaled \$19.930 billion, \$2.481 billion or 14.2% above last year. Awards and grants spending is up \$839 million or 7.1% through the first nine months while operations spending is down \$92 million or 1.8%.

The largest increase in spending has occurred in Medicaid grant spending from the Department of Public Aid, up \$651 million to \$4.460 billion this year or 17.1% from \$3.809 billion in the first nine months of last year. A closer look at the pace of Medicaid spending is revealing. Medicaid spending from current years' appropriations of \$4.445 billion has utilized 80.1% of current year appropriation authority with three months left in the fiscal year. The spike in Medicaid spending in fiscal year 2004 is due to a concentrated effort to pay Medicaid claims in order to accelerate federal

matching dollars returned to the cash-strapped General Revenue Fund and to address unpaid claims remaining from fiscal year 2003.

Other areas of grant spending which increased over the first three-quarters include State Board of Education grants (up \$161 million or 4.4%), Teachers' Retirement System grants (up \$46 million or 6.6%) and Human Services grants (up \$18 million or 0.9%). Appropriations are up \$315 million, \$53 million and \$111 million respectively.

The only area of grant spending which declined over nine months was higher education grants (down \$49 million or 7.3%). Appropriations are down \$44 million.

Regular state operations expenditures decreased by \$29 million or 0.8% and higher education operations decreased by \$63 million or 4.3% in the first nine months of fiscal year 2004.

What Lies Ahead?

While the economy shows recent signs of improvement, a few positive revenue months do not necessarily signal a turnaround in the state economy. The state faces several challenges for the remainder of fiscal year 2004 and going into fiscal year 2005.

Cash Management

The immediate task at hand is to maintain cash flow over the next quarter to meet the state's obligations and operational needs. Fiscal uncertainties remain as some projected revenue enhancements have not yet occurred. The sale of the 10th riverboat license, expected to raise \$350 million in revenues, has now been delayed to fiscal year 2005. Revenues from the sale of state assets, anticipated to generate another \$233 million, have not yet materialized and may not reach projections. Transfers for administrative chargebacks and fee increases have at this point fallen short of estimated levels.

Additional revenues will be critical over the next two months as over \$797.4 million, in addition to those monies already set aside for debt service, will be needed to payback short-term borrowing from last year. Payment delays will lengthen and increased backlogs will occur as the state attempts to meet its schedule of transfer and payment obligations. For example, the General Revenue Fund must transfer another \$290 million

for short-term borrowing repayment between April 1 and April 14. The March end of month balance of \$155 million includes \$100 million set aside for transfer on April 1. By June 30th, the state must also replenish \$276 to the Budget Stabilization or Rainy Day Fund.

Because of the necessary build up in the balance to allow the state to make its loan payment, the figure for the cash balance as adjusted to reflect unpaid bills is overstated by approximately \$100 million. To end the year with a significant improvement in this adjusted balance, most if not all of the revenue enhancements and estimates projected last spring will have to be realized. As the third quarter concludes, the year has already seen lowered estimates from traditional revenue sources (income and sales) than those used to build the fiscal year 2004 budget. These declines were offset, however, by the additional federal aid that was not calculated into the budget passed last spring.

Fiscal Year 2005 State Budget

As budget makers attempt to craft the fiscal year 2005 state budget, they will have to confront not only any deficits between fiscal year 2004 revenues and expenditures, but also the potential unavailability or reduction of many of the aforementioned revenue sources used to structure the fiscal year 2004 budget last spring. These include, but are not necessarily limited to, the following:

	(\$ Millions)
Pension Obligation Bond proceeds included in FY 2004 budget assumptions	\$1,600
Sale of state assets	233
10th Riverboat License	350
Surplus Fund Transfers	153
Administrative Charge-backs	330
Cigarette Tax Changes	50
Tax Amnesty Revenues in FY 2004	290
TOTAL	\$3,006

Combined with approximately \$750 million in additional federal grants and reimbursements obtained over the course of the current year that will likely not be forthcoming in fiscal year 2005, the Governor and General Assembly will have to identify nearly \$3.8 billion in revenue sources or savings to construct a balanced state budget in fiscal year 2005. ●

GENERAL FUNDS TRANSACTIONS
(Dollars in Millions)

	March		Change	Nine Months		Change	
	2003	2004		FY 2003	FY 2004	Amount	Percent
AVAILABLE CASH BALANCE, BEGINNING	\$ 118	\$ 182	\$ 64	\$ 256	\$ 317	\$ 61	23.8 %
REVENUES:							
State Sources:							
Cash Receipts:							
Income Taxes:							
Individual	\$ 513	\$ 555	\$ 42	\$ 5,172	\$ 5,090	\$ (82)	(1.6) %
Corporate	155	174	19	474	647	173	36.5
Total, Income Taxes	668	729	61	5,646	5,737	91	1.6
Sales Taxes	455	513	58	4,520	4,742	222	4.9
Other Sources:							
Public Utility Taxes	98	129	31	749	806	57	7.6
Cigarette Taxes	33	33	0	300	300	0	0.0
Inheritance Tax (gross)	14	17	3	189	152	(37)	(19.6)
Liquor Gallonage Taxes	8	9	1	94	94	0	0.0
Insurance Tax and Fees	54	60	6	193	228	35	18.1
Corporation Franchise Tax and Fees	16	16	0	106	120	14	13.2
Investment Income	4	5	1	51	42	(9)	(17.6)
Cook County IGT	23	23	0	243	280	37	15.2
Riverboat Gambling Taxes	0	12	12	0	89	89	N/A
Other	15	35	20	270	249	(22)	(8.1)
Total, Other Sources	265	339	74	2,195	2,359	164	7.5
Total, Cash Receipts	\$ 1,388	\$ 1,581	\$ 193	\$ 12,361	\$ 12,838	\$ 477	3.9 %
Transfers In:							
Lottery Fund	\$ 44	\$ 68	\$ 24	\$ 379	\$ 417	\$ 38	10.0 %
State Gaming Fund	28	30	2	427	404	(23)	(5.4)
Pension Contribution Fund	0	131	131	0	1,395	1,395	N/A
Other Funds	41	72	31	438	664	226	51.6
Total, Transfers In	\$ 113	\$ 301	\$ 188	\$ 1,244	\$ 2,880	\$ 1,636	131.5 %
Total, State Sources	\$ 1,501	\$ 1,882	\$ 381	\$ 13,605	\$ 15,718	\$ 2,113	15.5 %
Federal Sources:							
Cash Receipts	\$ 255	\$ 394	\$ 139	\$ 2,762	\$ 3,967	\$ 1,205	43.6 %
Transfers In	0	7	7	24	41	17	70.8
Total, Federal Sources	\$ 255	\$ 401	\$ 146	\$ 2,786	\$ 4,008	\$ 1,222	43.9 %
Total, Base Revenues	\$ 1,756	\$ 2,283	\$ 527	\$ 16,391	\$ 19,726	\$ 3,335	20.3 %
Short-Term Borrowing	0	0	0	700	0	(700)	(100.0)
Transfer from Budget Stabilization Fund	0	0	0	226	226	0	0.0
Total, Revenues	\$ 1,756	\$ 2,283	\$ 527	\$ 17,317	\$ 19,952	\$ 2,635	15.2 %
Expenditures:							
Awards and Grants:							
State Board of Education	\$ 569	\$ 591	\$ 22	\$ 3,638	\$ 3,799	\$ 161	4.4 %
Public Aid	317	352	35	3,809	4,460	651	17.1
Human Services	200	213	13	2,052	2,070	18	0.9
Teachers Retirement	78	82	4	698	744	46	6.6
Higher Education	60	62	2	670	621	(49)	(7.3)
All Other Grants	60	105	45	898	910	12	1.3
Total, Awards and Grants	1,284	1,405	121	11,765	12,604	839	7.1
Operations:							
Other Agencies	364	398	34	3,652	3,623	(29)	(0.8)
Higher Education	106	144	38	1,452	1,389	(63)	(4.3)
Total, Operations	470	542	72	5,104	5,012	(92)	(1.8)
Regular Transfers Out	146	135	(11)	1,384	1,399	15	1.1
All Other (Includes Prior Year Adjustments)	2	0	(2)	16	14	(2)	(12.5)
Vouchers Payable Adjustment	(352)	(156)	196	(1,020)	271	1,291	N/A
Total, Base Expenditures	\$ 1,550	\$ 1,926	\$ 376	\$ 17,249	\$ 19,300	\$ 2,051	11.9 %
Transfers to Repay Short-Term Borrowing	200	200	0	200	630	430	N/A
Total, Expenditures	1,750	2,126	376	17,449	19,930	2,481	14.2
AVAILABLE CASH BALANCE, ENDING	\$ 124	\$ 339	\$ 215	\$ 124	\$ 339	\$ 215	173.4 %

GENERAL REVENUE FUND TRANSACTIONS
(Dollars in Millions)

	<u>March</u>		<u>Change</u>	<u>Nine Months</u>		<u>Change</u>	
	<u>2003</u>	<u>2004</u>		<u>FY 2003</u>	<u>FY 2004</u>	<u>Amount</u>	<u>Percent</u>
AVAILABLE CASH BALANCE, BEGINNING	\$ 28	\$ 8	\$ (20)	\$ 0	\$ 1	\$ 1	N/A %
Revenues:							
State Sources:							
Cash Receipts:							
Income Taxes:							
Individual	\$ 475	\$ 515	\$ 40	\$ 4,794	\$ 4,703	\$ (91)	(1.9) %
Corporate	144	161	17	440	529	89	20.2
Total, Income Taxes	619	676	57	5,234	5,232	(2)	(0.0)
Sales Taxes	342	385	43	3,395	3,522	127	3.7
Other Sources:							
Public Utility Taxes	89	118	29	671	721	50	7.5
Cigarette Taxes	22	22	0	197	194	(3)	(1.5)
Inheritance Tax (gross)	14	17	3	189	152	(37)	(19.6)
Liquor Gallonage Taxes	8	9	1	94	94	0	0.0
Insurance Tax and Fees	54	60	6	193	228	35	18.1
Corporation Franchise Tax and Fees	16	16	0	106	120	14	13.2
Investment Income	4	5	1	51	42	(9)	(17.6)
Cook County IGT	23	23	0	243	280	37	15.2
Other	15	34	19	262	243	(19)	(7.3)
Total, Other Sources	245	304	59	2,006	2,074	68	3.4
Total, Cash Receipts	\$ 1,206	\$ 1,365	\$ 159	\$ 10,635	\$ 10,828	\$ 193	1.8 %
Transfers In:							
Regular Transfers In	\$ 41	\$ 72	\$ 31	\$ 438	\$ 664	\$ 226	51.6 %
Pension Contribution Fund	0	131	131	0	1,395	1,395	N/A
Total, Transfers In	\$ 41	\$ 203	\$ 162	\$ 438	\$ 2,059	\$ 1,621	370.1 %
Total, State Sources	\$ 1,247	\$ 1,568	\$ 321	\$ 11,073	\$ 12,887	\$ 1,814	16.4 %
Federal Sources:							
Cash Receipts	\$ 255	\$ 394	\$ 139	\$ 2,762	\$ 3,967	\$ 1,205	43.6 %
Transfers In	0	7	7	24	41	17	70.8
Total, Federal Sources	\$ 255	\$ 401	\$ 146	\$ 2,786	\$ 4,008	\$ 1,222	43.9 %
Total, Base Revenues	\$ 1,502	\$ 1,969	\$ 467	\$ 13,859	\$ 16,895	\$ 3,036	21.9 %
Short-Term Borrowing	0	0	0	700	0	(700)	(100.0)
Transfer from Budget Stabilization Fund	0	0	0	226	226	0	0.0
Total, Revenues	\$ 1,502	\$ 1,969	\$ 467	\$ 14,785	\$ 17,121	\$ 2,336	15.8 %
Expenditures:							
Awards and Grants:							
Public Aid	\$ 317	\$ 352	\$ 35	\$ 3,809	\$ 4,460	\$ 651	17.1 %
State Board of Education	308	305	(3)	1,530	1,480	(50)	(3.3)
Human Services	200	213	13	2,052	2,070	18	0.9
Higher Education	60	62	2	509	525	16	3.1
Children and Family Services	26	46	20	440	421	(19)	(4.3)
All Other Grants	41	65	24	513	542	29	5.7
Total, Awards and Grants	952	1,043	91	8,853	9,498	645	7.3
Operations:							
Other Agencies	364	398	34	3,652	3,623	(29)	(0.8)
Higher Education	103	144	41	1,275	1,389	114	8.9
Total, Operations	467	542	75	4,927	5,012	85	1.7
Regular Transfers Out	278	193	(85)	1,746	1,542	(204)	(11.7)
All Other (Includes Prior Adjustments)	2	0	(2)	16	14	(2)	(12.5)
Vouchers Payable Adjustment	(400)	(156)	244	(988)	271	1,259	(127.4)
Total, Base Expenditures	\$ 1,299	\$ 1,622	\$ 323	\$ 14,554	\$ 16,337	\$ 1,783	12.3 %
Transfers to Repay Short-Term Borrowing	200	200	0	200	630	430	N/A
Total, Expenditures	1,499	1,822	323	14,754	16,967	2,213	15.0
AVAILABLE CASH BALANCE, ENDING	\$ 31	\$ 155	\$ 124	\$ 31	\$ 155	\$ 124	400.0 %